

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: OCT 30 2001

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

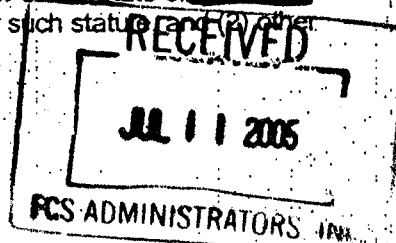
Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

In your application, you state that you were formed as a trust fund by a predecessor agreement to the current Trust Agreement on [REDACTED]. On [REDACTED] that predecessor agreement was amended and restated as the current Trust Agreement. You are a trust under [REDACTED] law. The Trust Agreement is your organizing instrument and provides that you are formed exclusively for the benefit of certain organizations (Employers, also referred to as Supported Organizations) that meet the following criteria:

- (1) the organization is recognized as exempt under section 501(c)(3) of the Code,
- (2) the organization is engaged, or shall become engaged upon admission to participation in the Trust pursuant to the Trust Agreement, in the rendering of various human services, including but not limited to services for persons with mental illnesses, mental retardation, developmental disabilities, and alcohol and substance abuse problems,
- (3) the organization is accepted as a participant in the Trust by the Trustees in accordance with the terms of the Trust Agreement, and
- (4) the organization signifies a desire in writing to become a participant in the Trust and agrees in writing to be bound by the terms and provisions of the Trust Agreement.

The Trust Agreement provides that you will establish and maintain (1) a group self-insurance plan under Article 4 of the Workers' Compensation Law of the State of [REDACTED] which shall enable the Employers to meet their obligations under such statute and (2) other

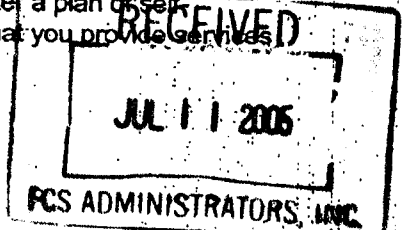


plans to assist the Employers with their obligations to provide employee benefits, including but not limited to disability benefit plans under Article 9 of the Workers' Compensation Law; provided, however, that you are not empowered to provide commercial-type insurance, as that term is used in section 501(m) of the Code.

The Trust Agreement provides, among other items, that your Trustees are empowered :

- (1) To pay or provide for the payment of all reasonable and necessary expenses of collecting Employer payments and administering your affairs, including the employment of such administrative, legal, actuarial and other expert assistance or services, auditing, bookkeeping and clerical services or assistance, the leasing or purchasing of such premises, materials, supplies, and equipment as your Trustees in their discretion find necessary or appropriate in the performance of their duties.
- (2) To establish, in so far as the Workers' Compensation or disability benefit coverage is concerned, a contribution rate or rates for each Employer which shall be sufficient to pay all of your operating expenses and all of the operating obligations due under the Workers' Compensation Law.
- (3) To employ an experience modification factor to achieve an equitable allocation of premium based on the frequency and severity of losses incurred by each Employer.
- (4) To compromise, settle, arbitrate, and release claims or demands in favor of or against you or the Trustees on such terms and conditions as your Trustees may deem advisable.
- (5) To make equitable distribution of your assets, in the event of termination of the Agreement, among Employers then participating. A given Employer's equitable distribution shall be determined by crediting that Employer's cumulative contributions to you less its total claims expenses and allocated share of the administrative overhead incurred in connection with said Employer's participation in the Trust.
- (6) To hold, manage, and control your assets, during your continuance, and to have full power without court order to improve, lease, rent, sell, exchange, hold, control, invest, and reinvest the same in such manner and upon such terms as they deem best, including (without limitation of these powers) the power to purchase shares in investment trusts and stock in investment corporations irrespective of any statutes or rules or practices of courts now or hereafter in force limiting the investments of trust companies or trustees generally.

In your application, you state that your sole purpose is to support not-for-profit human-services agencies (Supported Organizations, also referred to as Employers) that are exempt under section 501(c)(3) of the Code. You state that the Supported Organizations control you because they are members of the Trust and thereby elect your trustees. You state that your primary activity in support of the Supported Organizations is to administer a plan of self-insurance to fund their worker's compensation obligations. You state that you provide services



[REDACTED]

to the Supported Organizations, services that include a group self-insurance plan and other plans to assist the Employers with their obligations to provide employee benefits, including, but not limited to, disability benefit plans. You state that you do not provide (and are not empowered to provide) commercial-type insurance, and that you seek to be recognized as a "supporting organization" under section 509(a)(3). You also state that member assessments are made based on your experience and your anticipated expenses. You state that you are not providing commercial-type insurance because risk is not shifted from the members to you or any other party.

You state that workers compensation insurance premiums are very expensive in [REDACTED] for exempt organizations, and by providing this self-insured coverage and by engaging a third-party administrator to provide services, you will both cover the workers compensation obligations of the Supported Organizations and do so at a lower overall cost than the Supported Organizations would incur if they had to purchase commercial workers' compensation insurance. Thus, you intend to lower the overall costs of all the Supported Organizations and thereby improve the services the Supported Organizations provide to the beneficiaries of their charitable services.

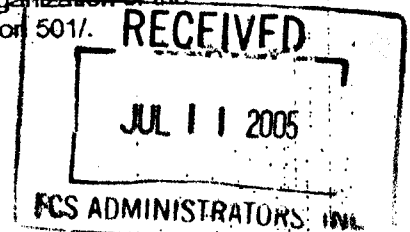
The financial data in your application shows that your primary source of income consists of contributions from member employers. Your primary expense consists of claims paid and provision for claims and claim adjustment.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, or educational purposes so long as no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

In construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau of Washington, D.C., Inc. v. U.S., 326 U.S. 279 (1945), CT. D. 1650, C.B. 1945, 375, the Supreme Court of the United States said, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes." This rationale applies equally to any category of charitable purpose under section 501(c)(3) of the Code.

Section 501(m)(1) of the Code provides that an organization described in section 501(c)(3) or (4) will be eligible for recognition of exemption under section 501(a) only if no substantial part of its activities consists of providing commercial-type insurance.

Section 513 of the Code defines the term "unrelated trade or business," in the case of an organization described in section 501(a), as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the purposes or function constituting the basis for its exemption under section 501(c)(3).



[REDACTED]

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of any exempt purpose.

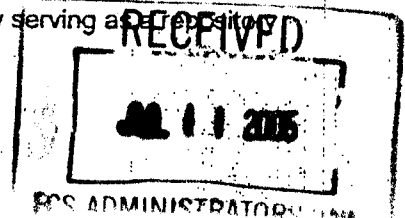
Section 1.502-1(b) of the regulations provides, in part, that if a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization. However, the regulation continues, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.

Rev. Rul. 71-529, 1971-2 C.B. 234, holds that a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualified for exemption under section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, holds that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish the activities as charitable.

Rev. Rul. 75-282, 1975-2 C.B. 201, holds that an organization formed and controlled by an exempt conference of churches that makes mortgage loans to affiliated churches to finance the construction of church buildings is carrying out an integral part of the activities of the parent church organization, and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 78-41, 1978-1 C.B. 148, describes a situation in which a hospital that is exempt under section 501(c)(3) of the Code establishes a trust to accumulate and hold funds for use in satisfying malpractice claims against the hospital. The hospital is required by the state hospital licensing authority to carry 500x dollars of malpractice insurance, or to set aside in some manner 500x dollars for this purpose. The revenue ruling states that by serving as a repository



[REDACTED]

for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust is operating as an integral part of the hospital. Further, the trust is performing a function that the hospital could do directly. Accordingly, the organization is operated exclusively for charitable purposes and, thus, is exempt under section 501(c)(3).

You are not like the organizations described in Rev. Ruls. 75-282 and 78-41, both supra, because you are not an integral part of any particular organization. Instead, you are providing services for a fee to a number of exempt organizations that are related to each other only with regard to their purposes. You have no parent organization, and your members are not subsidiaries of any parent organization. Although the service you provide, the establishment and maintenance of a self-insurance plan to fund your members' worker's compensation obligations, could be performed by any one of your exempt members for itself without jeopardizing its individual exempt status, you are more similar to the organizations described in section 1.502-1(b) of the regulations that are not exempt from tax because they are providing unrelated trade or business services to unrelated exempt organizations. It is immaterial whether the services you provide are or are not described as commercial-type insurance as defined in section 501(m)(1) of the Code. You are more similar to the organization discussed in Rev. Rul. 72-369, supra, which was denied exemption under section 501(c)(3) because it was furnishing services at cost rather than substantially below cost as the organization discussed in Rev. Rul. 71-529, supra.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter

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FCS ADMINISTRATORS, INC.

[REDACTED]

questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
T:EO:RA:T:2 - [REDACTED]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

✓
Vcc: [REDACTED]

